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SUBJECT: Argentina: Fiscal Situation Steadily Deteriorating But No Major Problems Until 2011

REF: BUENOS AIRES 118

Summary and Comment

11. (SBU) The long-term Argentine fiscal situation is deteriorating. The fiscal gap is manageable in 2010, but will be difficult to overcome in 2011 without a restoration of the government's ability to borrow on the international financial markets. The GOA has, so far, managed to bridge the gap during the last few years via the use of internal sources of financing from public Argentine institutions and one-off payments from institutions such as the Central Bank (BCRA) and the Social Security Agency (ANSES). While these payments will be made in 2010, when the fiscal gap is estimated to be in the USD 3-5 billion range, they cannot be depended on to continue indefinitely. In 2011, however, the gap is forecast by some to balloon to as high as USD 14 billion.

12. (SBU) With this in mind, the government's quest for supplemental sources of funds led it to establish the (as yet unrealized) Bicentennial Fund and is also likely behind its efforts to solve the problem of the holdouts from the 2005 debt restructuring, which should increase its ability to borrow on the international markets. In addition, the government just announced the appointment of a Kirchner-aligned economist as the President of the BCRA, who is likely to accommodate the government's expansionary fiscal program. These steps make it somewhat less likely that the government will resort to extraordinary actions reminiscent of the decision in 2008 to nationalize privately-held pension funds. This additional monetary and fiscal expansion brings with it the specter of inflation, which is already accelerating and expected to reach 20 percent in 2010. End
Summary and Comment.

Surplus Decreased 47% from 2008 to 2009

13. (SBU) According to the Argentine Ministry of Economy, the primary fiscal surplus decreased 47% y-o-y from ARP 32 billion in 2008 to ARP 17.3 billion in 2009. The 2009 surplus -- equivalent to 1.5% of GDP -- is well below 2008's 3.1% level. While these figures do indicate that Argentina's fiscal situation is worsening, they understate the overall deterioration in the GOA's fiscal stance. The official figures for 2009 include: extraordinary income of about ARP 9.5 billion related to the IMF's Special Drawing Rights (SDR) allocation to the Argentine Central Bank (BCRA) -- an amount determined by an IMF member country's shareholder stake; accounting earnings of ARP 8.3 billion from the accrual of interest and dividends on funds held at the Social Security Agency (ANSES), assets which had previously been managed by private pension funds prior to their nationalization in late 2008; and the distribution of ARP 4.5 billion in unrealized BCRA profits, mostly due to the peso's depreciation.

2009 "Surplus" is Actually a Deficit

14. (SBU) Deducting these three extraordinary items from the positive side of the fiscal ledger, the 2009 government-reported ARP 17.3 billion (1.5%) surplus turns into an actual deficit of ARP 4.5 billion, or 0.4% of GDP. Consultant and former Economy Ministry Director General Javier Alvaredo told Dep EconCouns recently that, according to his calculations, the true primary fiscal deficit for 2009 was 1.6% of GDP. Regardless of which figure is more accurate, the trend is clear. There has been a steady deterioration on the fiscal front in recent years. After reaching almost 4% of GDP in 2004, the true primary fiscal surplus halved to about 2% in 2007 and 2008 and went into free-fall in 2009, turning into a deficit.

Expenditures Keep Growing

15. (SBU) Regarding the rate of growth of tax collection and expenditures, the picture is unpromising, casting doubts on the GOA's ability or willingness to control spending. In 2007, 2008, and 2009, tax collection, according to government figures, increased 33%, 35%, and 13%, respectively, compared to a growth in primary expenditures of 44%, 35% and 30%, respectively. In 2010, the government does not appear to be on track to moderate spending growth, leading private analysts to forecast a further deterioration in its fiscal position. Private estimates of the primary fiscal balance for the year range from a deficit of 1% of GDP to a surplus of 0.5%, depending on the assumptions used. A Banco Galicia report forecasts expenditure growth of 27% versus growth in tax collections of 24%, leading to a primary fiscal surplus of ARP 13 billion (or about 1% of GDP). Macrovision Consulting estimates that primary spending will increase 26% and tax collections 23%, leading to a balanced primary fiscal result. Alvaredo came in with a much more negative forecast for 2010, saying that a 34% primary spending increase (an average of the last three years, according to his own calculations), will generate a primary fiscal deficit of 2.5% of GDP. He also posited a scenario in which primary expenditures would only increase by 25%, which would improve the primary fiscal deficit to 1% of GDP.

¶6. (SBU) In spite of the range of forecasts for the fiscal accounts, analysts generally believe that the GOA's financial program is manageable through the end of 2010. If the debt restructuring for the holdouts is carried out sometime during the first quarter of 2010, that transaction is expected to bring about USD 1 billion in new cash to the GOA. Furthermore, the GOA is still thought to retain a few pockets of liquidity that it could tap to meet its financing needs. The largest, as in past years, are the BCRA's expected 2010 profits of about ARP 20 billion and

ANSES' expected 2010 interest earnings of around ARP 8 billion. The appointment of Kirchner loyalist Mercedes Marco del Pont as the new President of the BCRA increases the likelihood that the BCRA will act in accord with the government's fiscal plans.

Substantial Deterioration in 2011

¶7. (SBU) Banco Galicia Chief Economist Nicolas Dujovne says that the 2010 fiscal gap will total about USD 3.5 billion. He arrives at this figure after taking into account USD 1 billion in cash raised in the debt exchange, USD 1.6 billion in continuing support from international financial institutions that still operate in Argentina, and the support of ANSES and BCRA mentioned above. Dujovne explained that it will be easy to manage this gap, even without the potential additional assets provided by the Bicentennial Fund, which is still pending Congressional approval that could come as early as March when Congress reconvenes. Assuming that the Bicentennial Fund is authorized and the government makes full use of those newly-available funds, Dujovne says that expenditures could grow as much as 37% without expanding the financial gap beyond USD 3.5 billion. Beyond 2010, the picture gets much worse, as he forecasts a 2011 financing gap of almost USD 14 billion, even taking into account continued extraordinary income from ANSES (he does not foresee any from the BCRA), which is certainly not assured. As Dujovne puts it, "Two Bicentennial Funds will be necessary if public expenditures are maintained at the same pace as in 2009 (+30%)."

No "Credit Event" Expected in 2010

¶8. (SBU) Standard and Poor's Argentine Country Director Sebastian Briozzo told Dep EconCouns that the fiscal situation is continuing its slow and steady deterioration. He said that the government's long-term strategy of tapping internal sources of financing by rolling over debt with public entities is running out of fuel. However, he maintained that whatever the fiscal gap ends up being in 2010, it ought to be easily manageable for a country with an economy the size of Argentina's. The GOA's plan to set up the Bicentennial Fund was meant to enable the government to pursue a more aggressive and expansive fiscal policy. It would allow considerable room for maneuver in terms of increasing discretionary public spending, likely to be used to bolster support for the government among provincial governors who face a grim fiscal situation now.

¶9. (SBU) Briozzo forecast a reasonable economic performance in

2010, with no "credit event" expected. While he did not completely rule out extraordinary measures similar to the 2008 nationalization of the pension funds, Briozzo expressed a certain optimism regarding the short-term, especially if the debt restructuring proposal proceeds and the country begins to borrow on the international markets. He added, however, that the situation in 2011 looked considerably grimmer, and could only be alleviated by

access to international borrowing. Otherwise, he noted, the government might be forced to take another extraordinary step similar to the pension nationalization.

"Disastrous Consequences for Inflation"

110. (SBU) Javier Alvaredo also characterized the creation of the Bicentennial Fund as a political act designed to facilitate additional discretionary spending. He pointed out that the fine print in the decree that established it leaves open the theoretical possibility of almost tripling it at some point to about USD 18 billion. Even prior to the appointment of the new BCRA President, he viewed the Bank and its Board of Directors as weak and overly responsive to the Kirchners. As such, he said it stands ready to monetize GOA fiscal needs, with "disastrous consequences for inflation."

MARTINEZ